Trade Policy Review for China: The World Top Exporter with New Normal Economic Growth

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1. INTRODUCTION

The WTO's sixth trade policy review (TPR) of China in 2016 was undertaken in a period of economic slowdown in China. China had enjoyed strong economic growth for a few years after the 2007–2008 global financial crises, partially due to the stimulus packages installed by Chinese government. During the period under review (2014-2016), Chinese economy has entered a "New Normal" situation with stable but lower GDP growth. Real GDP growth rate was 7.3 per cent in 2014 and 6.7 per cent in 2016, down from 7.9 per cent in 2012.[1]

China remains as the top exporter in the world during this period, when the growth in constant US dollar value of world exports turns sluggish in 2015 and 2016 at 3.39 per cent and 2.69 per cent, down from 3.61 per cent in 2014. The current dollar value of world trade declined sharply in 2015 as total world trade falls by 10.76 per cent. The sharp decline of world trade in current dollar value was mitigated in 2016 with a fall of 2.56 per cent. Despite slow global trade growth, the share of Chinese exports in world exports remains stable each year during 2014-2016: being 10.56 per cent, 11.41 per cent and 10.63 per cent respectively. [2]

World Trade Statistical Review 2016 published by WTO argues that several factors contributed to the lacklustre performance in world trade: "economic slowdown in China, recessions in other large developing economies including Brazil, falling prices for oil and other primary commodities, strong fluctuations in exchange rates, and financial volatility driven by divergent monetary policies in developed countries". In such economic climate, Chinese government turns to rely more on domestic demand rather than exports. China has also expanded outward foreign direct investment (FDI) in this period, and the Belt and Road Initiative has been launched to promote trade and influence in Asian, Africa and Europe.

The rest of the paper is organized as follows. Section 2 overviews China's key trade policies in the review period. Section 3 examines China's economic performance, trade and investments. Section 4 discusses major challenges China would meet for it trade and economic growth. Section 5 concludes.

2. CHINA'S TRADE POLICIES

[1] Data source for GDP growth is from People's Bank of China (2017), China Financial Stability Report 2016, on http://www.pbc.gov.cn/jinrongwendingju/146766/146772/146776/3350799/2017072516522223298.pdf.

[2] Figures are calculated by the author, using date from World Bank, World Development indicators, on http://data.worldbank.org/data-catalog/world-development-indicators

China's main trade-policy objectives have not changed significantly since the last WTO trade policy review in 2014. China continued liberalizing its trade and investment regime to reshape its economy. China considers that the multilateral trading system (MTS) plays a leading role in China's process of opening up, and regional trade agreements are viewed as a complement to the MTS. China's policy of "opening up" focuses on the modernization of existing industries, the development of clean and knowledge-based industries, and the services sector. China has continued to focus on facilitating trade by launching reforms to make customs procedures more efficient both for exports and imports during this period. Paperless customs clearance was implemented across China and pilot paperless customs clearance scheme was expanded to more areas besides Shanghai, such as Tianjin, Fujian, Guangdong, Ningbo and Suzhou.[3]

As for FDI, China guides FDI into emerging industries, high-tech industries, energy conservation and environmental protection industries. These goals have been reflected in the latest 2015 investment and in the expansion of the China (Shanghai) Pilot Free Trade Zone (CSPFTZ), launched in 2013, and the establishment of other pilot free trade zones (in Guangdong, Tianjin and Fujian). China is also promoting its "Going Abroad Policy", as outward direct investment is considered a way to promote trade.

A key Chinese foreign and economic policy in the period under review is the "Belt and Road Initiative", an ambitious development campaign through which China aims to boost trade and stimulate economic growth across Asia and beyond. It plans to build massive amounts of infrastructure connecting China to countries in Asian and the globe. The initiative is to jointly build the Silk Road Economic Belt and 21st-Century Maritime Silk Road, raised by President Xi Jinping during visits to Central and Southeast Asia in 2013 and issued by the National Development and Reform Commission and ministries of foreign affairs and commerce. The initiative aims to "promote orderly and free flow of economic factors, highly efficient allocation of resources and deep integration of markets by enhancing connectivity of Asian, European and African continents and their adjacent seas"[4].

Originally the Belt and Road Initiative was launched to rival the trade agreement in pacific area Trans-Pacific Partnership (TPP), which is a trade agreement between 12 countries in Asian and Pacific area excluding China. TPP is likely to bring China's neighbours closer to the United States and reduce their dependence on Chinese trade and aims to strengthen American influence on future rules for the global economy. The contents of the TPP go far beyond the standards drafted by the World Trade Organization. Both TPP and Belt and Road Initiative could be regarded as new framework of trade and economic agreements outside of WTO. When Donald Trump inaugurated president, he announced United States' withdrawal from the TPP, which leads TPP to an uncertain future. However, China's Belt and Road Initiative continues as a main policy in the review period and the years to come.

In March 2015 China unveiled the action plan on the Belt and Road Initiative, including the principles, framework, and cooperation priorities and mechanisms in the initiative in a bid to

[3] Special Column 3 in Chinese Foreign Trade Situation Report (Spring 2017), www.mofcom.gov.cn
[4] News on 28th March 2015 Xinhua News Agency, http://www.english.gov.cn/news/

enhance regional connectivity, and serve as a geopolitical move to boost China's regional influence. Related outward foreign direct investment in the regions increased significantly: in 2016, total flows of outward FDI by Chinese enterprises to the countries covered by the Belt and Road Initiative reached $14.5 billion, accounting for 8.5 per cent of the total flows. And related foreign contracted projects amounted to $126 billion, an annual growth of 36 per cent. Trade value with these countries was $6300 billion in 2016, a growth of 0.6 per cent.[5]

Another trade policy Chinese authorities implement is to reform the framework and mechanism to fit for new developments in trade: expanding cross-border e-commerce, promoting markets trading, and setting up foreign trade comprehensive services enterprises.[6] Hangzhou, where the largest e-commence Chinese company Alibaba is based, hosts the first Cross-Border E-Commerce Comprehensive Pilot Zone in 2015. International trade made in this zone in 2016 amounted to RMB163.7 billion, over doubled in a year. At the beginning of 2016, the authorities expanded new Cross-Border E-Commerce Comprehensive Pilot Zones in 12 cities, such as Shanghai, Tianjing, Chongqing, and Guangzhou, to support new innovations in e-commence business. Trade through the mode of market trading has increased 16 per cent to RMB203.9 billion in 2016. There were four Foreign Trade Comprehensive Services Pilot Enterprises provided services for more than 40,000 median and small firms in the same year.[7] Chinese government aims to keep up with innovations and developments in international trade, adjust and develop related mechanism to achieve long-term trade growth in the era of rapid developments of e-commence and information technology.

3. PERFORMANCE ON ECONOMIC GROWTH, TRADE AND FDI

Since 2011 China has been adopting economic policy to boost domestic consumption and make it the major force driving growth, which was reflected in reality during the review period: strong domestic demand increasingly contributed to GDP growth (Table 1 Row 2), supported by domestic credit expansion and rising incomes. In addition to have a lower rate of new normal economic growth, China's policymakers aimed to rebalance the economy from investment-led to consumption-based. And that is gradually taking place as reflected in Table 1 Row 4 showing fixed assets investment growth rate dropped during 2012–2016. Consumer price inflation has remained moderate in this period, increasing by 2 per cent in two out of three years, with lowest of 1.4 per cent in 2015.

The reliability of Chinese economic data is a controversial issue. China's GDP figures in the period fitted well with the authority's target of 7 per cent annual growth. Mainstream media such as The Economist and Financial Times and academics share the view that Chinese authorities tend to smooth data: understated during times of rapid growth and overstated

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[5] Date source: Special Column 2 in Chinese Foreign Trade Situation Report (Spring 2017), www.mofcom.gov.cn

[6] On 9th May 2016, the government issued a document called "Suggestions on Promoting Stable and Better Foreign Trade".

[7] Special Column 1 in Chinese Foreign Trade Situation Report (Spring 2017), www.mofcom.gov.cn

during the current slowdown.[8] China's current Premier Li Keqiang back in 2007 described regional GDP data as "man-made" and unreliable. He instead suggested determining growth from electricity consumption, rail freight volumes and amount of loans disbursed. Economists followed his way and calculated the Li Keqiang index as a way to put official data into perspective. We also report some of the indicators in Table 1.

Table 1 Selected Economic Performance Indicators, 2012-2016

Year	2012	2013	2014	2015	2016
GDP (growth rate %)	7.9	7.8	7.3	6.9	6.7
Consumption contribution to GDP growth (in percentage)	4.3	3.7	3.7	4.6	4.7
Industrial output (growth rate %)	8.1	7.7	7	6	6
Fixed assets investment (growth rate %)	20.3	19.3	15.3	9.8	7.9
Share of Manufacture sector in GDP	47.1	47.2	47.2	46.9	40.7
Share of Service sector in GDP	44.1	44.4	44.6	45.1	50.7
Electricity Production (growth rate %)	4.7	8.9	4.2	2.8	5.2
Electricity consumption (growth rate %)	5.9	8.9	4	2.9	
Total Energy Consumption (growth rate %)	3.9	3.7	2.1	1	
Total Freight Volumes (growth rate %)	-0.7	1.6	-3.9	-11.9	-0.8
Railway Freight Volumes(growth rate %)	12.1	9.1	-2.7	4.2	-3.7
CPI (%)	2.6	2.6	2	1.4	2
PPI (output price, %)	-1.7	-1.9	-1.9	-5.2	-1.3
PPI (input price, %)	-1.8	-2	-2.2	-6.1	-1.9

Note: Data sources: People's Bank of China (2017), China Financial Stability Report 2016 on http://www.pbc.gov.cn/jinrongwendingju/146766/146772/146776/3350799/2017072516522223298.pdf, and Yearly and Monthly data from National Bureau of Statistics on www.data.stats.gov.cn

Figure 1 shows the growth rates for electricity consumption (and production)[9] and the growth in freight volumes to get a comprehensive picture about economic activities in China. We can see that the peak is in 2013 and the trough is in 2015 for both electricity production and total freight volume, despite the smooth down trend of GDP growth.[10] In 2015, China also experienced a huge turmoil in the stock market, falling some 40 per cent from peak to trough. It is understood that Li Keqiang index focuses too much on traditional industry while neglecting China's transition towards domestic consumption and the service sector. Table 1 also reports the shares of manufacture sector and service sector in GDP[11], and we can see that at least until 2015, the service sector remains a stable upward trend with a percentage of around 45 per cent in GDP, whereas in 2016 the proportion jumps significantly by 5

[8] For example, Nakamura, Steinsson, and Liu (2016) examines the growth and inflation data for China during 1996 to 2010.

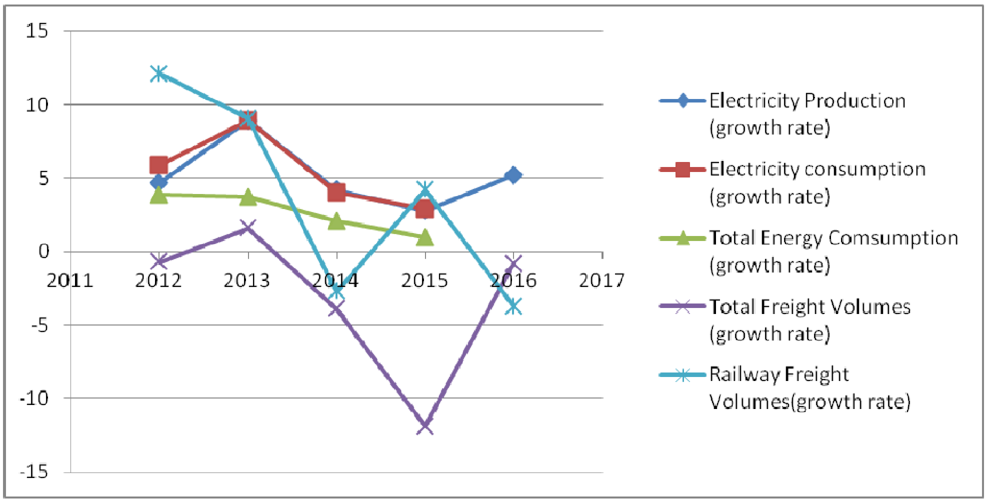
[9] Data for electricity consumption in 2016 is not available; therefore electricity production data in 2016 is reported to see the trend as they are highly related.

[10] The only exception is the rail freight volume, which takes up only 8 to 9 per cent of total freight during this period. The rail freight volume doesn’t represent the true trend of the whole picture.

[11] The shares are calculated by the author, using monthly data taken from National Statistics Bureau website on www.data.stats.gov.cn.

percentage point. This partly implies that the inconsistence between official GDP growth rates and energy consumptions or freight volumes cannot be explained by significant change in the role of service sector until 2015. Moreover, the higher share of service sector in GDP didn't lead to any reduction of the energy consumptions and freight volumes in 2016.

Figure 1 Energy Consumptions and Freight Volumes



Another big doubt is about the official inflation rates which could be used to manipulate the real GDP growth. Inflation rates are also important for evaluating long-term equilibrium exchange rates, which in turn affects exports and imports of a country. The CPI of 2 per cent or lower in this period is suspiciously low, considering that the broad money M2 (a key economic indicator used to forecast inflation) growth rates remain at high level in the range of 11 per cent to 13 per cent in this period and the growth rates of disposable income at around 9 percent to 10 per cent. Table 2 reports the indices. Surely these were partly countered by the decline in world prices of primary commodities.

Table 2 Monetary and Income Indicators

Year	2012	2013	2014	2015	2016
M2(100million Yuan)	974148.8	1106525	1228375	1392278	1550067
M2 (growth rate %)	13.8	13.6	12.2	13.3	11.3
M1 (growth rate %)	6.5	9.3	3.2	15.2	21.4
M0 (growth rate %)	7.7	7.2	2.9	4.9	8.1
Foreign exchange reserve (growth rate %)	4.1	15.4	0.6	-13.3	-9.6
Real disposable income per capita (Yuan)		18310.8	20167.1	21966.2	23821
Real disposable income per capita (growth rate %)			8	7.4	6.3
Nominal median of disposable income per capita (Yuan)		15632.1	17569.8	19281.1	20883
Nominal median of disposable income per capita (growth rate %)			12.4	9.7	8.3
Real disposable wage per capita (Yuan)		10410.8	11420.6	12459	13455
Real disposable wage per capita (growth rate %)			9.7	9.1	8

Note: Data sources: People's Bank of China (2017), China Financial Stability Report 2016 (http://www.pbc.gov.cn/jinrongwendingju/146766/146772/146776/3350799/2017072516522223298.pdf), and Yearly and Monthly data from National Bureau of Statistics on www.data.stats.gov.cn

Despite the decline of world trade since 2015 (in terms of current US dollar value), China still maintained a stable export share in world trade, recording the highest in 2015. Table 3 reports the statistics for trade. However, the importance of trade in Chinese economy, expressed as the share of exports and imports in GDP, has declined in this period. Trade surplus increased dramatically until 2015, whereas in 2016 trade surplus recorded a negative growth of -14.1 per cent

When taking a closer look at Chinese trade, we can see that service trade played an increasingly important role, with import of services grew at 23.2 per cent in 2016. Exports of services remain a stable growth rate of around 9 per cent. In the past thirty years, processing trade played a key role in Chinese exports and imports. This mode of trade has declined gradually in this period as Chinese authorities promoted ordinary trade with higher value added. China's top export destinations were the US (18.4 per cent), the EU (16.2 per cent), Hong Kong (13.7 per cent), ASEAN (12.2 per cent), and Japan (6.2 per cent) in 2016.[12]

Table 3 Trade and FDI Indicators

Year	2012	2013	2014	2015	2016
Share of Chinese exports in world exports	9.5	10	10.6	11.4	10.6
Share of Chinese imports in world imports	8.7	9.3	9.7	9.8	9.6
Exports (% of GDP)	25.4	24.5	24.1	22	19.6
Imports (% of GDP)	22.7	22.1	21.6	18.5	17.4
Total trade growth rate	6.2	7.5	3.4	-8.1	-6.8
Exports growth rate	7.9	7.8	6	-2.9	-7.7
Imports growth rate	4.3	7.2	0.5	-14.3	-5.5
Trade surplus growth rate	48.7	12.5	47.9	55	-14.1
Share of service exports in total exports	9.3	8.8	8.9	9.2	9.5
Share of service exports in total imports	14.5	15.6	19.3	21.8	23.2
Share of processing trade	42.1	39.0	37.7	35.1	34.1
Inflow FDI growth rate (actual)	-3.7	5.3	1.7	5.6	-0.2
Outflow FDI growth rate	17.6	22.8	14.2	18.3	

Notes: 1. Figures are all in percentage. 2. Data sources: World Bank, World Development indicators (http://data.worldbank.org/data-catalog/world-development-indicators), 2015 Statistical Bulletin of China's Outward Foreign Direct Investment (www.mofcom.gov.cn), and Yearly and Monthly data from National Bureau of Statistics (www.data.stats.gov.cn).

Foreign Direct Investment has played a crucial role on Chinese economic growth. During the period under review, the Government has extended the policy of facilitating FDI inflows through the gradual removal of restrictions, through implementing incentive schemes, and through liberalization in the four existing Pilot Free Trade Zones. The FDI inflow recorded positive growth rates in the first two years but a negative growth rate in 2016. However, the

[12] The author calculated from data in Chinese Foreign Trade Situation Report (Spring 2017) on Ministry of Commence of the People's Republic of China official website www.mofcom.gov.cn

FDI outward grew much faster in this period with growth rates over 14 per cent per year. China's outward FDI flows and stock in 2015 accounted for 9.9 per cent and 4.4 per cent of the global total respectively. For the first time, China ranked second among all countries (regions) in terms of outward FDI flows[13]. In terms of stock, China ranked 8th.[14] Also in 2015 for the first time, China's outward FDI exceeded inward FDI. China has entered a period of net capital outflow.

4. MAIN CHALLENGES ON TRADE AND ECONOMY IN CHINA

Amid the stable economic growth, China's trade growth and economic transition will continue to be complex, challenging, and potentially bumpy. There are long-term and continuing challenges such as sustainable development and protection of environment, upgrading to service sector and high tech industry. Here we highlight three challenges that may be more urgent in the near future for the authorities.

The first challenge for China's trade especially exports is Renminbi (RMB) exchange rates and rising labour costs. China kept on maintaining a managed floating exchange rate regime, which takes a basket of currencies as reference, with the floating range of the RMB exchange rate being gradually expanded during the period of review. Since 2013, the People's Bank of China has pushed forward reform to let the market play a more important role in exchange rate formation. Figure 2 shows the RMB exchange rates against major currencies (expressed as RMB per unit of foreign currency) in this period. Although by the end of 2016 RMB depreciated against US dollar by 13.8 per cent from the beginning 2014, RMB appreciated against other major currencies. This is reflected by the appreciation of both real and nominal effective exchange rate of RMB in the period of 2014 to 2016, as shown in Figure 3. From the beginning of 2015 to first half of 2016, REER and NEER maintained at high level with about 12 per cent higher relative to the low level at the start of 2014 and end of 2016. The appreciation of RMB effective exchange rates made firms difficult to exports, whereas imports benefited from strong purchase power of RMB in international markets. Continuing rising labour costs with an annual growth rate of around 9 per cent (Table 2) added big burdens on exporters. Chinese exporters found that international buyers were switching to other Asian countries with lower labour costs such as Vietnam, Bangladesh, and Pakistan.

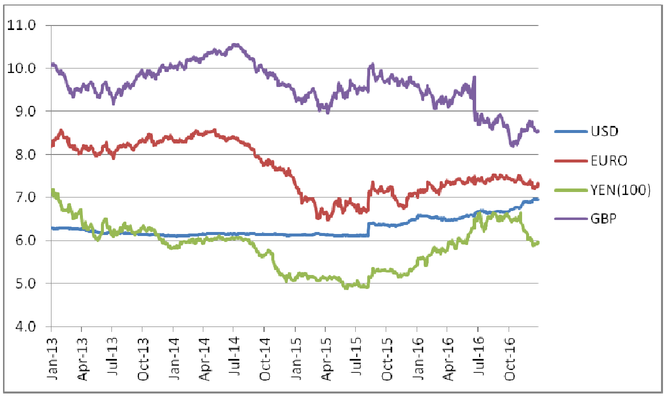
RMB exchange rate policy is also a fundamental international macroeconomic issue for China. China has achieved impressive progress on interest rate liberalization and internationalization of RMB during the period of review. But there is dilemma between RMB internationalization and capital controls: a high degree of RMB internationalization requires

[13] Date source: 2015 Statistical Bulletin of China's Outward Foreign Direct Investment (www.mofcom.gov.cn). However, data from World Investment Report 2017 compiled by UNCTAD shows that China ranked second in terms of outward FDI flows only in 2016, not 2015 as claimed by Chinese statistics. Under close scrutiny, the Chinese data published by UNCTAD shows huge variation deviated from the main trend with the growth rate of 3.6 per cent and 43.5 per cent respectively in 2015 and 2016. Therefore this paper relies on Chinese statistics, and data for 2016 is not available until later this year.

[14] Date source: 2015 Statistical Bulletin of China's Outward Foreign Direct Investment, www.mofcom.gov.cn

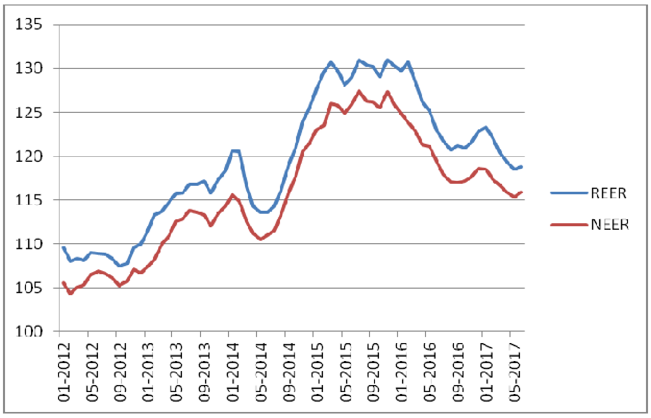
significant capital account liberalization—supported by financial market liberalization.[15] The authorities would have to give up capital controls in order to completely internationalize RMB, which is unlikely to happen in the near future. China has built up big inflation pressure to depreciate RMB since the financial crises in 2008: the purchasing power of RMB declined significantly within the country.[16] However, RMB exchange rate has appreciated against major currencies to a considerable extent. China had got little chance to deprecate its currency in the years before 2016, maybe due to the pressure from developed countries.

Figure 2 RMB Exchange Rates against Major Currencies



Notes: 1. data sources: IMF exchange rate data, Exchange Rate Query Tool www.imf.org/external/np/fin/ert/GUI/Pages/CountryDataBase.aspx. 2. The exchange rates are expressed as RMB per unit of foreign currency, calculated by using exchange rates between each currency against SDR. An increase indicates a depreciation.

Figure 3 Nominal and Real Effective Exchange Rates (NEER and REER) for RMB



Notes: 1. data sources: Bank for International Settlement (BIS) Statistics Explorer, http://stats.bis.org/statx/toc/LBS.html . 2. Nominal Effective Exchange Rates are calculated as geometric weighted averages of bilateral exchange rates. Real Effective Exchange Rates are the same weighted averages of bilateral exchange rates adjusted by relative consumer prices CPI. An increase in the index (2010=100) indicates an appreciation.

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15 Eichengreen and Kawai (2014), Issues for Renminbi Internationalization: An Overview, ADBI Working Paper 454.

16 The actual domestic inflation rate during the review period is unknown. Nakamura, Steinsson, and Liu (2016) investigates Chinese inflation data in an earlier period and their estimates indicate that true inflation was much higher than the official figures in the period after 2000.

Capital within China tried to leave the country to avoid a possible big depreciation. In 2015, foreign exchange reserves in China dropped dramatically at the rate of -13.3 per cent, and the drop continued in 2016 at -9.6 per cent, as shown in Table 2. As a consequence, the authorities imposed tougher capital control policy in 2017: reducing the annual quota enormously for residents purchase of foreign exchange in China from $50,000 to RMB50, 000 ($7, 400), and tightening the approval procedure for resident foreign exchange purchase. Considering the domestic inflation pressure and the potential benefits for exporters, China has good reasons to depreciate RMB. However, importers, outward investors and developed countries impose pressure for a stable or appreciation of RMB. How well the government could balance the two is a big challenge and a key issue China has to deal with in the future.

The second challenge is the effectiveness of the investments under the Belt and Road Initiative. China put this initiative as a main policy by spending billions of dollars to open up and create new markets for Chinese goods and technology, to help export excess cement and steel capacity by shifting factories overseas to less developed countries. More importantly, it is a foreign policy to connect neighbouring countries and expand China's influence globally as a leader. How to effectively use the investments, and bring trade and economic benefits for China is a challenge the authorities will have to deal with. Projects in some central and south Asian less-developing countries may not generate good profits, and western countries are suspicious of the initiative and are not actively involved. With a bad record of allocating resources efficiently at home, there are doubts about Chinese banks' ability to control financial risks, which may lead to new asset-quality problems for Chinese banks due to the funding for the initiative.[17] The long-term effects of the outward FDI under the initiative is uncertain.

The third challenge is to control credit risks and maintain the stability of financial system. Since the financial crises in 2008, Chinese government has adopted stimulus packages, expansionary monetary policies and proactive fiscal policies to stabilize economic growth, which has in turn led to a sharp rise in credit and debt levels. This is characterised by big asset price surges, such as properties in top cities and bit coins. Credit growth has been averaging around 20 percent per year in the past years, much higher than nominal GDP growth and the previous trend. China's credit gap is comparable with those experienced previously by countries such as Thailand, Spain and Japan that subsequently experienced "painful deleveraging". [18] In May 2017, Moody's lowers China's credit rating for first time since 1989 to reflect concerns over rising debt. [19] It will be a big challenge for Chinese government to bring an enormous credit bubble under control while keep the economic growth stable in the near future. This would also greatly affect trade performance in China.

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[17] Peter Wells and Don Weinland (2017), "Fitch warns on expected returns from One Belt, One Road", Financial Times, 2017-01-26

[18] IMF working paper WP/16/203, "Resolving China's Corporate Debt Problem", available on https://www.imf.org/external/pubs/ft/wp/2016/wp16203.pdf.

[19] "Rating Action: Moody's downgrades China's rating to A1 from Aa3 and changes outlook to stable from negative", Global Credit Research - 24 May 2017, Moody's Investors Service, available on https://www.moodys.com/research/

5. CONCLUSIONS

As China's economy has become more crucial to rest of the world, its trade policies and economic growth have significant effects on global trade and economy. The sixth WTO Trade Policy Review provides detailed information and discussions on comprehensive aspects of China's trade and economic growth, and related policies, laws and regulations. This paper reviewed the WTO review, and went beyond it. We added more information and most recent statistics to examine more closely the situation of China's economy and trade, aiming to show a more complete picture of the reality in China.

Major trade policies during the period 2014 to 2016 were summarized as the Belt and Road Initiative, policy on facilitating trade, and the new adjustments to support and promote e-commence. After checking the statistics of China's trade and economic performance, we discussed three challenges that Chinese government needs to deal with in the near future: RMB exchange rate policy and rising labour costs, the efficiency of the Belt and Road Initiative, and the management of credit risks and financial system stability.

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